

business of farming. A person cultivating or operating a farm for recreation or pleasure rather than a profit is not engaged in the business of farming. For the purpose of this section, the term *farm* is used in its ordinary, accepted sense and includes stock, dairy, poultry, fish, fruit, and truck farms, and also plantations, ranches, ranges, and orchards. A fish farm is an area where fish are grown or raised, as opposed to merely caught or harvested; that is, an area where they are artificially fed, protected, cared for, etc. A taxpayer is engaged in "the business of farming" if he is a member of a partnership engaged in the business of farming. See paragraphs (a)(8)(i) and (c)(1)(iv) of § 1.702-1.

[T.D. 6649, 28 FR 3762, Apr. 18, 1963]

§ 1.175-4 Definition of "land used in farming."

(a) *Requirements.* For purposes of section 175, the term *land used in farming* means land which is used in the business of farming and which meets both of the following requirements:

(1) The land must be used for the production of crops, fruits, or other agricultural products, including fish, or for the sustenance of livestock. The term *livestock* includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry. Land used for the sustenance of livestock includes land used for grazing such livestock.

(2) The land must be or have been so used either by the taxpayer or his tenant at some time before or at the same time as, the taxpayer makes the expenditures for soil or water conservation or for the prevention of the erosion of land. The taxpayer will be considered to have used the land in farming before making such expenditure if he or his tenant has employed the land in a farming use in the past. If the expenditures are made by the taxpayer in respect of land newly acquired from one who immediately prior to the acquisition was using it in farming, the taxpayer will be considered to be using the land in farming at the time that such expenditures are made, if the use which is made by the taxpayer of the land from the time of its acquisition by him is substantially a continuation of

its use in farming, whether for the same farming use as that of the taxpayer's predecessor or for one of the other uses specified in paragraph (a)(1) of this section.

(b) *Examples.* The provisions of paragraph (a) of this section may be illustrated by the following examples:

Example 1. A purchases an operating farm from B in the autumn after B has harvested his crops. Prior to spring plowing and planting when the land is idle because of the season, A makes certain soil and water conservation expenditures on this farm. At the time such expenditures are made the land is considered to be used by A in farming, and A may deduct such expenditures under section 175, subject to the other requisite conditions of such section.

Example 2. C acquires uncultivated land, not previously used in farming, which he intends to develop for farming. Prior to putting this land into production it is necessary for C to clear brush, construct earthen terraces and ponds, and make other soil and water conservation expenditures. The land is not used in farming at the same time that such expenditures are made. Therefore, C may not deduct such expenditures under section 175.

Example 3. D acquires several tracts of land from persons who had used such land immediately prior to D's acquisition for grazing cattle. D intends to use the land for growing grapes. In order to make the land suitable for this use, D constructs earthen terraces, builds drainage ditches and irrigation ditches, extensively treats the soil, and makes other soil and water conservation expenditures. The land is considered to be used in farming by D at the time he makes such expenditures, even though it is being prepared for a different type of farming activity than that engaged in by D's predecessors. Therefore, D may deduct such expenditures under section 175, subject to the other requisite conditions of such section.

(c) *Cross reference.* For rules relating to the allocation of expenditures that benefit both land used in farming and other land of the taxpayer, see § 1.175-7.

[T.D. 7740, 45 FR 78634, Nov. 26, 1980]

§ 1.175-5 Percentage limitation and carryover.

(a) *The limitation—(1) General rule.* The amount of soil and water conservation expenditures which the taxpayer may deduct under section 175 in any one taxable year is limited to 25 percent of his "gross income from farming".

(2) *Definition of "gross income from farming."* For the purpose of section 175, the term *gross income from farming* means the gross income of the taxpayer, derived in "the business of farming" as defined in § 1.175-3, from the production of crops, fruits, or other agricultural products, including fish, or from livestock (including livestock held for draft, breeding, or dairy purposes). It includes such income from land used in farming other than that upon which expenditures are made for soil or water conservation or for the prevention of erosion of land. It does not include gains from sales of assets such as farm machinery or gains from the disposition of land. A taxpayer shall compute his "gross income from farming" in accordance with his accounting method used in determining gross income. (See the regulations under section 61 relating to accounting methods used by farmers in determining gross income.) The provisions of this subparagraph may be illustrated by the following example:

Example. A, who uses the cash receipts and disbursements method of accounting, includes in his "gross income from farming" for purposes of determining the 25-percent limitation the following items:

Proceeds from sale of his 1955 yield of corn	\$10,000
Gain from disposition of old breeding cows replaced by younger cows	500
Total gross income from farming	10,500

A must exclude from "gross income from farming" the following items which are included in his gross income:

Gain from sale of tractor	\$100
Gain from sale of 40 acres of taxpayer's farm	8,000
Interest on loan to neighboring farmer	100

(3) *Deduction qualifies for net operating loss deduction.* Any amount allowed as a deduction under section 175, either for the year in which the expenditure is paid or incurred or for the year to which it is carried, is taken into account in computing a net operating loss for such taxable year. If a deduction for soil or water conservation expenditures has been taken into account in computing a net operating loss carryback or carryover, it shall not be considered a soil or water conservation expenditure for the year to which the

loss is carried, and therefore, is not subject to the 25-percent limitation for that year. The provisions of this subparagraph may be illustrated by the following example:

Example. Assume that in 1956 A has gross income from farming of \$4,000, soil and water conservation expenditures of \$1,600 and deductible farm expenses of \$3,500. Of the soil and water conservation expenditures \$1,000 is deductible in 1956. The \$600 in excess of 25 percent of A's gross income from farming is carried over into 1957. Assuming that A has no other income, his deductions of \$4,500 (\$1,000 plus \$3,500) exceed his gross income of \$4,000 by \$500. This \$500 will constitute a net operating loss which he must carry back two years and carry forward five years, until it has offset \$500 of taxable income. No part of this \$500 net operating loss carryback or carryover will be taken into account in determining the amount of soil and water conservation expenditures in the years to which it is carried.

(b) *Carryover of expenditures in excess of deduction.* The deduction for soil and water conservation expenditures in any one taxable year is limited to 25 percent of the taxpayer's gross income from farming. The taxpayer may carry over the excess of such expenditures over 25 percent of his gross income from farming into his next taxable year, and, if not deductible in that year, into the next year, and so on without limit as to time. In determining the deductible amount of such expenditures for any taxable year, the actual expenditures of that year shall be added to any such expenditures carried over from prior years, before applying the 25-percent limitation. Any such expenditures in excess of the deductible amount may be carried over during the taxpayer's entire existence. For this purpose in a farm partnership, since the 25-percent limitation is applied to each partner, not the partnership, the carryover may be carried forward during the life of the partner. The provisions of this paragraph may be illustrated by the following example:

Example. Assume the expenditures and income shown in the following table:

Year	Deductible soil and water conservation expenditures		Total	25 percent of gross income from farming	Excess to be carried forward
	Paid or incurred during taxable year	Carried forward from prior year			
1954	\$900	None	\$900	\$800	\$100
1955	1,000	\$100	1,100	900	200
1956	None	200	200	1,000	None

The deduction for 1954 is limited to \$800. The remainder, \$100 (\$900 minus \$800), not being deductible for 1954, is a carryover to 1955. For 1955, accordingly, the total of the expenditures to be taken into account is \$1,100 (the \$100 carryover and the \$1,000 actually paid in that year). The deduction for 1955 is limited to \$900, and the remainder of the \$1,100 total, or \$200, is a carryover to 1956. The deduction for 1956 consists solely of this carryover of \$200. Since the total expenditures, actual and carried-over, for 1956 are less than 25 percent of gross income from farming, there is no carryover into 1957.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6649, 28 FR 3762, Apr. 18, 1963]

§ 1.175-6 Adoption or change of method.

(a) *Adoption with consent.* A taxpayer may, without consent, adopt the method of treating expenditures for soil or water conservation as expenses for the first taxable year:

(1) Which begins after December 31, 1953, and ends after August 16, 1954, and

(2) For which soil or water conservation expenditures described in section 175(a) are paid or incurred.

Such adoption shall be made by claiming the deduction on his income tax return. For a taxable year ending prior to May 31, 1957, the adoption of the method described in section 175 shall be made by claiming the deduction on such return for that year, or by claiming the deduction on an amended return filed for that year on or before August 30, 1957.

(b) *Adoption with consent.* A taxpayer may adopt the method of treating soil and water conservation expenditures as provided by section 175 for any taxable year to which the section is applicable if consent is obtained from the district director for the internal revenue dis-

trict in which the taxpayer's return is required to be filed.

(c) *Change of method.* A taxpayer who has adopted the method of treating expenditures for soil or water conservation, as provided by section 175, may change from this method and capitalize such expenditures made after the effective date of the change, if he obtains the consent of the district director for the internal revenue district in which his return is required to be filed.

(d) *Request for consent to adopt or change method.* Where the consent of the district director is required under paragraph (b) or (c) of this section, the request for his consent shall be in writing, signed by the taxpayer or his authorized representative, and shall be filed not later than the date prescribed by law for filing the income tax return for the first taxable year to which the adoption of, or change of, method is to apply, or not later than August 20, 1957, following their adoption, whichever is later. The request shall:

(1) Set forth the name and address of the taxpayer;

(2) Designate the first taxable year to which the method or change of method is to apply;

(3) State whether the method or change of method is intended to apply to all expenditures within the permissible scope of section 175, or only to a particular project or farm and, if the latter, include such information as will identify the project or farm as to which the method or change of method is to apply;

(4) Set forth the amount of all soil and water conservation expenditures paid or incurred during the first taxable year for which the method or change of method is to apply; and

(5) State that the taxpayer will make an accounting segregation in his books and records of the expenditures to which the election relates.

(e) *Scope of method.* Except with the consent of the district director as provided in paragraph (b) or (c) of this section, the taxpayer's method of treating soil and water conservation expenditures described in section 175 shall apply to all such expenditures for the taxable year of adoption and all subsequent taxable years. Although a taxpayer may have elected to deduct soil